

REPORT OF THE AUDITOR-GENERAL TO THE COUNCIL OF THE NYANDENI LOCAL MUNICIPALITY AND THE EASTERN CAPE PROVINCIAL LEGISLATURE ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF NYANDENI LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2009

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Nyandeni Local Municipality which comprise the balance sheet as at 30 June 2009, the income statement, and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity specific basis of accounting as set out in accounting policy note 1 and in the manner required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA)] and section 126 (3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis for qualified opinion

Value added tax (VAT)

7. The VAT control account amounting to R1.3 million (2007-08: R365 242) that is included in debtors disclosed in the balance sheet and note 9 to the financial statements is overstated. The net VAT claimed from the South African Revenue Service according to the VAT returns submitted exceeded the net VAT recorded in the general ledger by R2.2 million (2007-08: R8.7 million). This excess was not supported by adequate supporting documentation and was not adequately explained. Furthermore, input VAT claimed from the South African Revenue Service has been overstated by R676 859 due to the use of an incorrect formula by the municipality.

Corresponding figures

8. The audit report on the financial statements for the year ended 30 June 2008 contained a qualified opinion as a result of material misstatements in the prior year with respect to fixed assets, provisions and creditors. Management has not corrected the misstatements identified and therefore the corresponding figures are still misstated.

Qualified opinion

9. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements of the Nyandeni Local Municipality have been prepared, in all material respects, in accordance with the basis of accounting as set out in accounting policy note 1 and in the manner required by the MFMA.

Emphasis of matters

I draw attention to the following matters:

Basis of accounting

10. The municipality's policy is to prepare financial statements on the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 to the financial statements.

Highlighting critically important matters presented or disclosed in the financial statements

Unauthorised Expenditure

11. Unauthorised expenditure of R1 379 531 is disclosed in note 27 to the financial statements. The unauthorised expenditure was incurred as a result of inadequate budget control.

Fruitless and wasteful expenditure

12. Fruitless and wasteful expenditure of R132 227 is disclosed in note 28 to the financial statements. This expenditure was incurred in one instance only, due to the cancellation of a reservation.

Irregular Expenditure

13. Irregular expenditure of R663 568 is disclosed in note 29 to the financial statements. This resulted from management's failure to ensure compliance with the requirements of relevant legislation and regulations in the approval of expenditure transactions.

Member of council arrear rates and service charges

14. The rates and service charges of members of council who have not paid their accounts for more than three months are disclosed in note 15 to the financial statements. Paragraph 12A of the code of conduct for members of council issued in terms of section 54 of the Municipal Systems Act, 2000 (Act 32 of 2000) prohibits members of council from being in arrear with their rates and service charge accounts for more than three months.

Other matters

I draw attention to the following matters that relates to my responsibilities in the audit of the financial statements:

Unaudited supplementary schedules

15. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

Non-compliance with applicable legislation

Municipal Finance Management Act

16. The cost of the fixed assets amounting to R201.9 million as per note 4 was supported by a fixed assets register, however a proper fixed assets register in terms of section 63 (2) (c) of the MFMA was not maintained as fixed assets were not marked with unique identification numbers that are appropriately cross-referenced to

the asset register. As a result, assets selected from the asset register could not be physically verified. As the fixed assets disclosed in the financial statements is stated at cost less loans redeemed and other capital receipts, the amount in the financial statements is not misstated.

17. The municipality did not make all payments to creditors within 30 days of receipt of the invoice, as required by Section 65(2) (e) of the MFMA.

Municipal Systems Act, 2000 (Act no. 32 of 2000) (MSA)

18. No performance contracts for the municipal manager and those managers reporting to him were in place during the year under review. This is a material contravention of section 57 of the MSA.
19. The members of council have not disclosed their direct and indirect business interests as required by section 54 of the MSA read with paragraph 5 (a) and (b) of schedule 1 code of conduct for councillors of the same act.

Environment Conservation Act, 1989 (Act no. 73 of 1989)

20. The Environment Conservation Act, 1989 (Act No. 73 of 1989), Section 20(1)(a) states that: "no person shall establish, provide or operate any disposal site without a permit issued by the Minister of Water Affairs and that the Minister may issue a permit subject to such conditions as he may deem fit."

A permit was not issued for the municipality's landfill site located in Moyeni Administrative Area in Libode.

Governance framework

21. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

Internal control deficiencies

22. Section 62(1) (c) (i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the [qualified/adverse/disclaimer of] opinion. The root causes are categorised according to the five components of an effective system of internal control. (The number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for qualified opinion	CE	RA	CA	IC	M
7	Value added tax (VAT)	5				

Legend	
CE = Control environment	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
RA = Risk assessment	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
CA = Control activities	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
IC = Information and communication	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
M = Monitoring	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self -assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

Key governance responsibilities

23. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
Clear trail of supporting documentation that is easily available and provided in a timely manner			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.	✓	

No.	Matter	Y	N
Quality of financial statements and related management information			
2.	The financial statements were not subject to any material amendments resulting from the audit.		✓
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.		✓
Timeliness of financial statements and management information			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines in section 126 of the MFMA.	✓	
5.	Key officials were available throughout the audit process.	✓	
Development and compliance with risk management, effective internal control and governance practices			
6.	Audit committee		
	<ul style="list-style-type: none"> The municipality had an audit committee in operation throughout the financial year. 	✓	
	<ul style="list-style-type: none"> The audit committee operates in accordance with approved, written terms of reference. 	✓	
	<ul style="list-style-type: none"> The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA. 		✓
7.	Internal audit		
	<ul style="list-style-type: none"> The municipality had an internal audit function in operation throughout the financial year. 	✓	
	<ul style="list-style-type: none"> The internal audit function operates in terms of an approved internal audit plan. 		✓
	<ul style="list-style-type: none"> The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA 		✓
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		✓
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		✓
10.	The information systems were appropriate to facilitate the preparation of the financial statements.	✓	
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(c)(i)/95(c)(i) of the MFMA.		✓
12.	Powers and duties have been assigned, as set out in section 79/106 of the MFMA.		✓
Follow-up of audit findings			
13.	The prior year audit findings have been substantially addressed.	✓	
14.	SCOPA/Oversight resolutions have been substantially implemented.	✓	
Issues relating to the reporting of performance information			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		✓
16.	Adequate control processes and procedures are designed and implemented to		✓

No.	Matter	Y	N
	ensure the accuracy and completeness of reported performance information.		
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the municipality against its mandate, predetermined objectives, outputs, indicators and targets [section 68/87 of the MFMA].	✓	
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.		✓

24. Key governance responsibilities, including the development and compliance with risk management, effective internal control and governance practices, have substantially not been implemented as reflected in the table above as the municipality does not have an appointed municipal manager to implement these structures and control systems.

25. The capacity of the finance department is inadequate to effectively support, manage and perform the required financial functions as reliance is placed on specific individuals in the municipality. The impact of this was that material adjustments were effected to the financial statements submitted for audit purposes.

26. The audit committee did not fulfil its responsibilities as the audit committee met once in the year and did not establish adequate measures to discharge its mandate.

27. The internal audit function was not effective due to the following:

- The head of internal audit acted as a municipal manager for a part of the year.
- The head of internal audit did not appear to be independent and reported directly to the acting municipal manager.
- The internal audit function did not perform risk assessments and advise management on performance management and compliance with laws and regulations nor prepare an annual internal audit plan to guide its operations.

Investigations

28. With reference to note 29 to the financial statements dealing with irregular expenditure, an investigation was conducted by an independent consulting firm on request of the municipality. The investigation was initiated based on an allegation of possible irregular payments made to officials of the municipality and has been completed at the reporting date. The investigation has resulted in disciplinary proceedings being instituted against the officials.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

29. I have reviewed the performance information as set out on pages xx to xx.

The accounting officer's responsibility for the performance information

30. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

The Auditor-General's responsibility

31. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

32. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

33. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings (performance information)

Non-compliance with regulatory requirements

Existence and functioning of a performance audit committee

34. The Nyandeni Local Municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.

Internal auditing of performance measurements

35. The internal auditors of Nyandeni Local Municipality did not audit the results of performance measurement as part of its internal audit processes, as required in terms of section 45 of the MSA.

Lack of adoption or implementation of a performance management system

36. The Nyandeni Local Municipality did not implement a framework that describes and represents how the municipality's performance management system works with respects to planning, monitoring of and reporting on performance against targets, including determining the roles of the different role players, as required in terms of regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

Usefulness and reliability of reported performance information

37. The following criteria were used to assess the usefulness and reliability of the information on the municipality's performance with respect to the objectives in its integrated development plan:

- Consistency: Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan?
- Relevance: Is the performance information as reflected in the indicators and targets clearly linked to the predetermined objectives and mandate. Is this specific and measurable, and is the time period or deadline for delivery specified?
- Reliability: Can the reported performance information be traced back to the source data or documentation and is the reported performance information accurate and complete in relation to the source data or documentation?

The following audit findings relate to the above criteria:

Inconsistently reported performance information

38. The Nyandeni Local Municipality did not report on all the targets and priorities as per the approved integrated development plan.

Reported performance information not relevant

39. The targets with regard to all of the objectives were not:

- specific in clearly identifying the nature and the required level of performance
- measurable in identifying the required performance
- time bound in specifying the time period or deadline for delivery.

Reported performance information not reliable

Lack of appropriate information systems generating performance information

40. Sufficient appropriate audit evidence with regard to the reported performance information of the objectives could not be obtained, as the information system used for generating performance information was not appropriate to ensure that the reported information was accurate and that all the information was included.

Source information not accurate and complete

41. The information to support the actual reported performance was not accurate and complete.

APPRECIATION

42. The assistance rendered by the staff of the Nyandeni Local Municipality during the audit is sincerely appreciated.

East London

30 November 2009



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence